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NO. 06-633

In The

Supreme Court of the United States

PHILIP MORRIS USA, INC., *ET AL.*,

Petitioners,

v.

STATE OF MINNESOTA,

Respondents.

On Petition for a Writ of Certiorari to the Minnesota Supreme Court

PETITIONERS' REPLY BRIEF

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PETITIONER'S REPLY BRIEF

The Petition raises an issue of extraordinary importance: whether the federal Contracts Clause requires a state to keep its word when it enters into a proprietary contract. Relying on a fundamental misreading of this Court's plurality opinion in *United States v. Winstar Corp.*, 518 U.S. 839 (1996) -- a case that has generated widespread confusion in the lower courts -- the Minnesota Supreme Court held that a state can impair such a contract at will as long as it does so through legislation that was not expressly barred by an "unmistakable promise" in the contract. Because few, if any, contracts *ever* satisfy such a standard, this Court should grant *certiorari* and clarify that the unmistakability doctrine does not apply to a state's proprietary contracts and that the Contracts Clause requires a state to keep its promises.

For over 130 years, this Court has interpreted the federal Contracts Clause as prohibiting state legislation that impairs proprietary contracts. This Court has made clear that states are not free to enact legislation that impairs their financial contractual obligations -- notwithstanding that such contracts ordinarily do not contain an explicit, "unmistakable" promise not to enact such legislation. Yet, by its decision, the Minnesota court transformed the Contracts Clause into an impotent mechanism to enforce proprietary contractual promises. Given the importance of this issue and the confusion engendered by *Winstar*, this Court should grant review. As the *Winstar* plurality itself recognized, this issue is vital because the proper application of the unmistakability doctrine implicates "the Government's own long-run interest as a reliable contracting partner." *Id.* at 883.

Perhaps recognizing the tenuous nature of the Minnesota court's ruling, Respondent spends much of its brief arguing that the Minnesota court relied exclusively on state grounds and that, therefore, this Court does not have jurisdiction. But the Minnesota court could not have avoided -- and did not avoid -- the federal constitutional issue by applying state law. The very purpose of the Contracts Clause is to provide federal protection against the abuse of state power, including the parochial interpretation of state laws by state courts. In upholding the Health Impact Fee under state law, the Minnesota court thus made consideration of the federal issue necessary. Furthermore, in purporting to apply state law, the Minnesota court principally relied on (albeit incorrectly) a federal case -- this Court's *Winstar* decision. The court looked to that federal case because it has long interpreted the Minnesota Contracts Clause as being coextensive with its federal counterpart. *See Christensen v. Minneapolis Mun. Employees Ret. Bd.*, 331 N.W.2d 740, 750-52 (Minn. 1983). Thus, the Minnesota court did address a federal issue. A federal question is squarely presented here, and this Court should grant review.

I. THE EXTENT TO WHICH THE UNMISTAKABILITY DOCTRINE APPLIES TO PROPRIETARY STATE CONTRACTS IS IN NEED OF CLARIFICATION BY THIS COURT.

In return for billions of dollars in payments made and to be made every year *in perpetuity* (as well as other consideration), Minnesota agreed not to seek the reimbursement of additional state heath care costs attributable to smoking from Petitioners. Yet, in enacting the Health Impact Fee, Minnesota has done precisely that: impose additional liability on defendants and their distributors for smoking-related health care costs. Petition ("Pet.") at 3-15. Notwithstanding that the contract was proprietary in nature, the Minnesota Supreme Court upheld the legislative

impairment by applying the unmistakability doctrine. Because the contract did not contain a second, unmistakable promise by Respondent not to impair its contractual obligations through legislation, the court upheld the impairment.

Respondent justifies this result by arguing that "Petitioners' assertion that the unmistakability doctrine does not apply to contracts a state enters into in its proprietary capacity is plainly incorrect." *See* Brief in Opposition ("Opp.") at 16 n.7. According to Respondent, the unmistakability doctrine applies to proprietary contracts. In fact, this Court has never applied that doctrine to such a contract.[1] In *Murray v. City of Charleston*, 96 U.S. 432 (1877), *United States Trust Co. of New York v. New Jersey*, 431 U.S. 1 (1977), as well as in other decisions, this Court has

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[1] Respondent cites *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130 (1982), as consistent with the holding below, Opp. at 19-21, but that case is entirely inapposite because it involved a purportedly sovereign contract. In *Merrion*, lessees contracted for mining rights on an Indian tribe's land. *Id.* at 146. The lessees, seeking to invalidate a later severance tax on oil and gas, argued that the contract was sovereign -- not proprietary -- and waived all of the tribe's sovereign power. Specifically, the lessees argued that an Indian tribe's sovereign power over non-tribe members derives wholly from the power to control entry onto tribal land. By allowing the lessees onto tribal land, the lessees argued, the tribe contractually "exempt[ed] them from [all] further exercises of the Tribe's sovereign authority." *Id.* at 145. This Court rejected the proffered limitation on the tribes' sovereign authority, instead holding that Indian tribes have the same sovereign power to tax non-tribe members as they do tribe-members. Once the Court reached this holding, it was a foregone conclusion that there was no "clear and unmistakable surrender of taxing power" in the leases. *Id.* at 148. Conversely, here, Petitioners do not argue that the settlement agreement effected a waiver of any sovereign power. Rather, both parties agree that the settlement agreement is a proprietary contract, and Petitioners contend that the Health Impact Fee impairs that contract by imposing the very liability for tobacco-related health care costs that the contract expressly released.

invalidated state legislation impairing a state's proprietary contractual obligations without applying the unmistakability doctrine. In doing so, this Court has made clear that the Contracts Clause subjects a state's proprietary contracts to the same contract-interpretation rules that apply to contracts between private parties. *See, e.g.*, *Winstar*, 518 U.S. at 887 n.32 ("[T]he Government is ordinarily treated just like a private party in its contractual dealings."); *U.S. Trust Co. of N.Y.*, 431 U.S. at 25 n.23 ("States and cities, when they borrow money and contract to repay it with interest, are not acting as sovereignties. They come down to the level of ordinary individuals. Their contracts have the same meaning as that of similar contracts between private persons.") (quoting *Murray*, 96 U.S. at 445); *Lynch v. United States*, 292 U.S. 571, 579 (1934) (When the government acts as a private contracting party, "its rights and duties are therein governed generally by the law applicable to contracts between private individuals.").[2]

Indeed, Respondent later *admits* that the unmistakability doctrine does not apply to at least some proprietary contracts. Opp. at 15 n.7 (conceding that *Murray* and *United States Trust* show that "some Contracts Clause cases involving proprietary contracts do not require application of the unmistakability doctrine"). But the distinction it draws between circumstances in which the doctrine does and does not apply is untenable. Under the

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[2] *See also Wood v. Lovett*, 313 U.S. 362, 368-69 (1941) (the Contracts Clause prohibited Alabama from repealing a statute creating a contractual obligation for Alabama to honor its sale of property for nonpayment of taxes); *Louisiana ex rel. Hubert v. City of New Orleans*, 215 U.S. 170 (1909) (the Contracts Clause prohibited Louisiana from passing a statute prohibiting the payment of money owed pursuant to contracts entered into by municipalities with the police board pursuant to a delegation of authority from the state).

Minnesota court's analysis, whenever a state chooses to impair a proprietary contract through a legislative act, the unmistakability doctrine would apply to defeat a Contracts Clause challenge. The reasoning is that, under such circumstances, the private party invoking the Contracts Clause inevitably challenges a state statute and necessarily would have to assert that the contract involves the "surrender of a sovereign power;" therefore, the unmistakability doctrine applies, even if the contract is proprietary. Op. at 14-15.

This approach conflicts with the express text of the Contracts Clause, which protects against attempts by a state to impair its own contractual obligations *through legislation*. *See* U.S. Const. art. I, § 10, cl. 1 ("No State shall . . . pass any . . . *Law* impairing the Obligation of Contracts.") (emphasis added). Indeed, the Clause was included in Article I, Section 10's list of prohibitions on state legislation precisely because the Framers foresaw the great temptation for state legislatures to use their sovereign power to evade inconvenient financial contractual commitments. *See Fletcher v. Peck*, 10 U.S. (6 Cranch) 87, 137-39 (1810) (Contracts Clause must be more strictly applied to state contracts than to contracts between private parties). This Court has therefore long held that "impairments of a State's own contracts . . . face more stringent examination under the Contracts Clause than would laws regulating contractual relationships between private parties." *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 n.15 (1978) (describing *U.S. Trust Co. of N.Y.*, 431 U.S. at 22-23). This is why, in cases like *Murray* and *United States Trust*, this Court struck down legislative attempts by states to impair their contractual obligations -- without applying the unmistakability doctrine.

Furthermore, the Minnesota court's flawed approach subjects a state's impairment of its own contractual obligations to *less scrutiny* than impairments of agreements between private parties receive; under its analysis, a state therefore has a *greater* ability to impair its own proprietary

contracts than it has to impair contracts between private parties. The Minnesota court's decision effectively nullifies a central purpose of the Contracts Clause by rendering state financial contracts vulnerable to precisely the form of legislative impairment that the Constitution is meant to foreclose. The decision thus sends a message to state legislatures that they can evade an inconvenient contractual commitment so long as they impair the contract through a form of legislation that the contract itself failed to anticipate and bar expressly.

Ultimately, Respondent's attempt to distinguish between legislative impairments and non-legislative breaches, reflects the confusion created on this issue by *Winstar*. Respondent quotes and relies on a snippet from *Winstar*: the plurality's statement that the application of the doctrine "turns on whether enforcement of the contractual obligation alleged would block the exercise of a sovereign power." Opp. at 15 (quoting *Winstar*, 518 U.S. at 879). To be sure, this *Winstar* quote, taken in isolation, could be read to support the Minnesota court's position. But, when read with the rest of *Winstar*, it does not support the proposition that the unmistakability doctrine applies to all state contracts that are legislatively impaired.

The *Winstar* plurality explained that "[t]he application of the doctrine . . . differ[s] according to the different kinds of obligations the Government may assume *and* the consequences of enforcing them." *Id.* (emphasis added). *Winstar* did not involve a proprietary contract, and the plurality's discussion of the unmistakability doctrine does not endorse application of that doctrine to proprietary contracts, whether the impairment occurs through legislation or otherwise. Rather, *Winstar* mandated a two-step inquiry beginning with the question of whether the contract is proprietary or sovereign. If the contract is proprietary -- *i.e.*, a commercial contract that does not on its face purport to surrender the state's sovereign powers -- the unmistakability

doctrine does not apply. *Id.* ("[N]o one would seriously contend that enforcement of humdrum supply contracts might be subject to the unmistakability doctrine."). If the contract is sovereign -- *i.e.*, allegedly surrenders a sovereign power -- the unmistakability doctrine applies if the relief requested "would block the exercise of a sovereign power." *Id.* at 879.

The *Winstar* plurality opinion -- read in full -- thus does not give states license to impair proprietary contracts through legislation. *Winstar* is fully consistent with *Murray*, *United States Trust*, and 130 years of this Court's jurisprudence -- all of which reject the Minnesota Supreme Court's analysis, and none of which the *Winstar* plurality purported to overrule. Yet, as Respondent concedes, post-*Winstar*, the lower courts have frequently acknowledged confusion about the diversity of interpretations of the unmistakability doctrine that case produced. *See* Opp. at 28; Pet. at 18-19 (collecting cases and academic commentary). The lower courts have become confused by a fractured decision of this Court and have misread the plurality opinion in a way that conflicts with longstanding precedent and eviscerates a central Constitutional protection. This Court needs to provide further guidance.

Finally, Respondent errs in asserting that special state law rules governing the interpretation of state contracts can make the Contracts Clause inapplicable. *See* Opp. at 9-10. This Court foreclosed recourse to state law as a means of evading the constraints of the Contracts Clause over 100 years ago in *Murray*. There, the City, like Respondent here, argued that the federal Contracts Clause was not implicated because, under state law rules of construction, the contract should be interpreted as allowing the sovereign to impair its terms through taxing legislation. *See* 96 U.S. at 444. This Court rejected the argument:

> It is against the rules, both of law and of reason, to admit by implication in the construction of a contract a principle which

> goes in destruction of it. The truth is, States and cities, when they borrow money and contract to repay it with interest, are not acting as sovereignties. They come down to the level of ordinary individuals. Their contracts have the same meaning as that of similar contracts between private persons. Hence, instead of there being in the undertaking of a State or city to pay, a reservation of a sovereign right to withhold payment, the contract should be regarded as an assurance that such a right will not be exercised. *A promise to pay, with a reserved right to deny or change the effect of the promise, is an absurdity.*

Id. at 445 (emphasis added). Similarly, when Respondent, in its proprietary capacity, entered into a contract releasing Petitioners from liability for reimbursement of financial costs in exchange for financial and other consideration, it "c[a]me down to the level of ordinary individuals" and the "contract[] ha[s] the same meaning as that of similar contracts between private persons." *Id.* To allow Respondent "to deny or change the effect of the promise" through subsequent legislation, as the Minnesota court has done, would be "an absurdity." *Id.*

In sum, application of the unmistakability doctrine to proprietary contracts would eliminate any meaningful protection of the Contracts Clause with respect to most state contracts. It would give states virtually unbridled power to abrogate any contract as long as they do so through legislation, especially through utilization of the taxing power. Absent assurance that states will be required to keep their promises, few parties will be willing "to undertake the risk of government contracting." *Winstar*, 518 U.S. at 913 (Breyer, J., concurring). And where, like here, the contract involves a significant amount of money, the risks undertaken by the contracting party would be completely unacceptable. Given

the importance of this issue to states and their contracting partners, lower courts and commentators have repeatedly asked this Court for additional guidance on the parameters of *Winstar*. This case provides an ideal vehicle for the Court to do so.

II. THIS COURT HAS, AND SHOULD EXERCISE, JURISDICTION.

Respondent also argues that this Court lacks jurisdiction because the Minnesota court did not cite to or rely upon the federal Contracts Clause in reaching in its decision (even though it is undisputed that Petitioners raised and fully briefed the issue below). *See* Opp. at 6-13. This argument is meritless. Whether or not the Minnesota court expressly addressed the issue below, the Contracts Clause is designed to provide federal protection against precisely the type of governmental impairment of contract at issue in this case. A federal issue is therefore clearly presented by the Petition.

In any event, the Minnesota court relied almost exclusively on this Court's opinion in *Winstar* to interpret the scope of its own constitutional provision. Accordingly, the court below necessarily addressed a federal question, and this Court has jurisdiction to review its determination. *See, e.g.*, *Delaware v. Prouse*, 440 U.S. 648, 652 (1979) (This Court has jurisdiction to review a state court's judgment where a state constitutional provision "will automatically be interpreted at least as broadly as [its federal counterpart]."); *Enter. Irrigation Dist. v. Farmers' Mut. Canal Co.*, 243 U.S. 157, 164 (1917) ("[W]here the non-Federal ground is so interwoven with the [federal question] as not to be an independent matter, or is not of sufficient breadth to sustain

the judgment without any decision of the other, our jurisdiction is plain.").[3]

Indeed, as the Petition demonstrates, Pet. at 15, without the erroneous application of the unmistakability doctrine, the Minnesota court likely would have ruled in Petitioners' favor. The fact that a lone concurring justice stated that he would have reached the same conclusion without applying the doctrine simply confirms this. If anything can be inferred from the concurring opinion, it is that the other justices, who did not join the opinion, disagreed with the reasoning contained therein.

CONCLUSION

This Court should grant *certiorari* to clarify that its plurality decision in *Winstar* did not reverse its longstanding jurisprudence that the unmistakability doctrine does not apply to contracts that a state enters into in its proprietary capacity.

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[3] The decisions cited by Respondent are inapposite because they involved state law grounds that were clearly independent of the federal challenge. For example, in *Coleman v. Thompson*, 501 U.S. 722 (1991) (cited in Opp. at 7), this Court found that a state court decision dismissing an appeal for petitioner's "failure to meet the [Virginia] Supreme Court's time requirements" rested on an independent and adequate state ground because the dismissal was the result of the state law rule that would apply no matter how the federal issue was decided. *Id.* at 740-41. Similarly, in *Herb v. Pitcairn*, 324 U.S. 117 (1945) (cited in Opp. at 7), this Court would not exercise jurisdiction until the Illinois Supreme Court clarified whether its holding was based on the independent and adequate state ground that petitioners had no actual case pending. *Id.* at 127. But where, as here, the state law question is "interwoven with the federal [question]" it is not "independent," and does not foreclose review by this Court. *Michigan v. Long*, 463 U.S. 1032, 1040 (1983).

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